State of California, California Health Facilities Financing Authority (CHFFA)

Pass-On Savings Study – Final Report

March 27, 2008

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Table of Contents

Executive Summary

When created in 1979, the California Health Facilities Financing Authority (CHFFA) was the primary organization providing non-profit health facilities in the state with access to the tax-exempt bond market to assist these entities in arranging health care projects. By using CHFFA, hospitals were able to obtain lower interest rates than by using traditional taxable vehicle bonds. Recognizing the benefit derived by non-profit hospitals obtaining CHFFA's tax-exempt financing, the Legislature believed that "all or part of" the resulting savings should be "passed on to the consuming public through lower charges or containment of the rate of increase in hospital rates." Recently, the Attorney General has opined that CHFFA has broad discretion in defining and implementing this provision of law.

In the ensuing 25 years, several Joint Power Authorities (JPA) throughout California began offering non-profit health facilities the same access to the tax-exempt bond market that had historically been the exclusive purview of CHFFA. As a result, CHFFA is now in competition with three or four alternate JPAs in serving borrowers for tax-exempt financing– a situation that was not the case in 1979. Moreover, it is important to note that the legislative intent language to pass-on "all or part" of the savings generated from financing through CHFFA is not a requirement placed on these JPAs—giving them a competitive advantage.

This advantage enjoyed by alternate JPAs was emphasized in 2007 when CHFFA quantified the "pass-on" savings it negotiated with Sutter Health at $8.5 million on an approved $958 million bond issue. Additionally, we learned that hospitals and their underwriters were experiencing significantly more public inquiry, as well as Board member questions and comments, when they presented their applications at CHFFA hearings than those experienced when applying for financing with other JPAs. This occurred during CHFFA hearings on hospital financing deals beginning in 2005. Some of these questions and comments resulted in CHFFA postponing approval of the hospital funding requests until at least the next scheduled meeting—usually 30 days hence.

Alternative Issuers are Providing Hospitals Tax-Exempt Funding

The cumulative impact of the "pass-on" situation has created a chilling effect on CHFFA's tax exempt bond financing activity. In the 11 months since the Sutter Health transaction, CHFFA only provided a minimal $27 million of tax-exempt bond financing—in stark contrast to the $1.1 billion per year it had averaged since 2002. Moreover, the number of bond issuances has dropped from an average 6 issuances annually to only 3 during the most recent year. This reduction in CHFFA's market share is occurring while hospital tax-exempt bond financing remains robust throughout California, including major deals with past CHFFA borrowers.

In interviews with large and small hospitals, health care associations, underwriters, bond counsel, and key stakeholders, it is crystal clear that hospitals and other health care providers will not return to CHFFA for their tax-exempt bond financing unless:

- CHFFA clearly defines the "pass-on" provision that ***does not*** generate higher costs than charged by competing JPAs; and

- CHFFA focuses its comments and those of the public on the merits of the proposed facility project(s).

Further, many believe that CHFFA should be more flexible in scheduling follow-up hearings in less than 30 days if initial hearings are postponed or held over for additional research—particularly since such delays can have a significant impact on construction and financing costs.

Pass-On Debate Should be Addressed by the Legislature

The world of health care in general, and hospital finance in particular, has changed dramatically since CHFFA's creation. What the Legislature envisioned as benefits of using CHFFA and how the savings should be utilized are no longer contemporary in 2008 with the advent of health maintenance organizations, managed care, and competing JPAs. CHFFA is no longer the only tax-exempt debt financing option available to hospitals, and lowering hospital rates will not directly benefit most health care consumers— since rates are primarily paid by HMOs or other third party providers, and not by the consuming public.

In today's environment, a non-profit hospital may not experience a benefit at all from using CHFFA since equal or better terms can be obtained from competing JPAs. Consequently, the original concept that using CHFFA generated savings from tax-exempt debt financing versus traditional taxable borrowing is no longer the case. Moreover, unless all conduit issuers—not just CHFFA—are mandated to assure that "pass-on" benefits are shared with the community, this dichotomy will continue. Service Employees International Union (SEIU) representatives we spoke with understood that CHFFA faced an uneven playing field on the "pass-on" provision when competing with alternative issuers.

The current unique pass-on requirement puts CHFFA in the unenviable position of championing the cause of non-profit hospital community benefit sharing with literally no ability to influence the outcome. As the Sutter transaction demonstrates, if CHFFA continues to require that "pass-on" benefits be quantified, non-profit hospitals will continue to shift towards using alternative JPAs to obtain tax-exempt financing as they have during the past year. At the end of the day, no additional community benefits will result despite CHFFA's sincere efforts, and the impact of lost revenues on CHFFA from no longer earning borrower administrative fees will place its operations in jeopardy.

Currently, there is a broad national and statewide debate being waged regarding whether non-profit health care providers, and other non-profits as well, are contributing enough to the community to justify their special tax-exempt status. The issue of a "pass-on" savings requirement for non-profit health facilities using conduit financing should be included in these debates. Moreover, whatever the outcome related to issuing tax-exempt debt, the statutory mandates and regulatory demands should be applied equally to all JPAs and similar issuers, not just CHFFA. It is for this reason that the "pass-on" debate should be discontinued in the limited CHFFA forum and is best focused in Congress and the California Legislature.

Recommendations

To address these issues, we recommend that CHFFA take a number of actions to regain its past role of being the issuer of choice for non-profit hospitals and health care facilities when they seek tax-exempt bond financing.

Specifically, CHFFA should adopt the following bylaws or standards:

- Until statutes are amended to provide clarification of the "pass-on" provision, utilize the guidance from Government Code § 15438.5 (c) to measure community benefits derived by the hospital financing proposal. That section defines "significant community service" for a health facility to meet prior to approval, including contracting with Medi-Cal and/or meeting other requirements.
- This provision could be used as a possible template when developing a "pass-on" policy. Additional information related to key community benefit indicators, such as charity care, quality assurance or transparency reporting could also be required.
- Establish protocols for public and Board comments to emphasize that CHFFA's role is to assist hospital and health care facility development within California while assuring the creditworthiness and earning capacity of each project, together with the pledged revenues, debt service coverage, and basic security.
- Require that public comments be provided in advance in writing, and establish a time limit for each commenter's presentation.
- Provide the option of calling special sessions of the CHFFA Board between regularly scheduled hearings to conduct business while meeting Bagley-Keene Act requirements for public notice.
- Modify and streamline CHFFA's application package to reduce unnecessary paperwork while assuring that financial eligibility standards are being met.
- Assist the Legislature in crafting language related to the pass-on requirement to assure that the final legislative solution does not place CHFFA at a competitive disadvantage with alternative issuers.

In the following sections, we expand on the issues identified during our study.

Background, Scope and Methodology

Nearly 30 years ago, the California Health Facilities Financing Authority (CHFFA) was created as the State's vehicle for providing financial assistance to public and non-profit health care providers in California through loans funded by the issuance of tax-exempt bonds. CHFFA was established in 1979 and operates pursuant to the California Health Facilities Financing Authority Act codified in Government Code Sections 15430 through 15462.5. The basic purpose of the legislation was to allow California health facilities to finance debt at lower interest rates; thus, making it easier to finance or refinance facility construction or acquisition projects. Legislative Committee bill analyses prepared at the time opined that if facilities' interest costs were lower, then this "savings" would inherently be passed on via lower charges or lower rate increases for both individuals and governments that reimburse Medicaid costs.

Borrower Eligibility and Pass-On Provisions

Over the years, CHFFA has financed a wide range of providers and systems throughout California from rural community-based organizations to large multi-hospital systems with the diverse nature of the facilities funded reflecting the changing needs of the State. Statutes guide the specific types of entities eligible for CHFFA's conduit financing of construction, expansion, remodeling, or renovation projects. In order to meet the requirements, an institution must be a public hospital, private non-profit corporation, or association authorized by the laws of California to provide or operate a health facility and undertake the financing or refinancing of a project. Eligibility covers a wide range of entities such as acute care hospitals, specialty centers, intermediate and skilled nursing care facilities, clinics and adult day health centers, and certain child day care facilities operated in conjunction with a health facility. By using CHFFA, hospitals and eligible entities can likely obtain lower interest rates than they would through conventional taxable bonds.

CHFFA enabling legislation also addresses the make-up and responsibility of the Board, as well as authorizes CHFFA to adopt bylaws guiding the regulation of its affairs and the conduct of its business. For instance, it allows CHFFA to give special consideration, on a case-by-case basis, to finance a project that does not meet the guidelines established by the Authority with respect to bond rating if the eligible health facility demonstrates the financial feasibility of the project and the performance of significant community service.

Legislation also contains intent language that "all or part of any savings experienced by a participating health institution, as a result of that tax-exempt revenue bond funding, be passed on to the consuming public through lower charges or containment of the rate of increase in hospital rates." Although the statutes state that it is "not the intent of the Legislature to authorize the authority to control or participate in the operation of hospitals."

In November 2005, the Attorney General issued an opinion on the "pass-on" provision and stated that a reference to this provision as a "requirement overstates the actual language of the statute…rather, it recites legislative goals and policies that must be implemented through CHFFA's exercise of judgment." Moreover, the Attorney General opined that "the absence

of a concrete "requirement" and of any related guidance leaves CHFFA with the discretion to implement the Legislature's broad goal as it sees fit within the parameters of the Act." In fact, that opinion stated that CHFFA's approach in 2005 of reviewing a participating health institution's charitable care policy and community benefit programs "appears to be appropriate absent any legislative indication to the contrary."

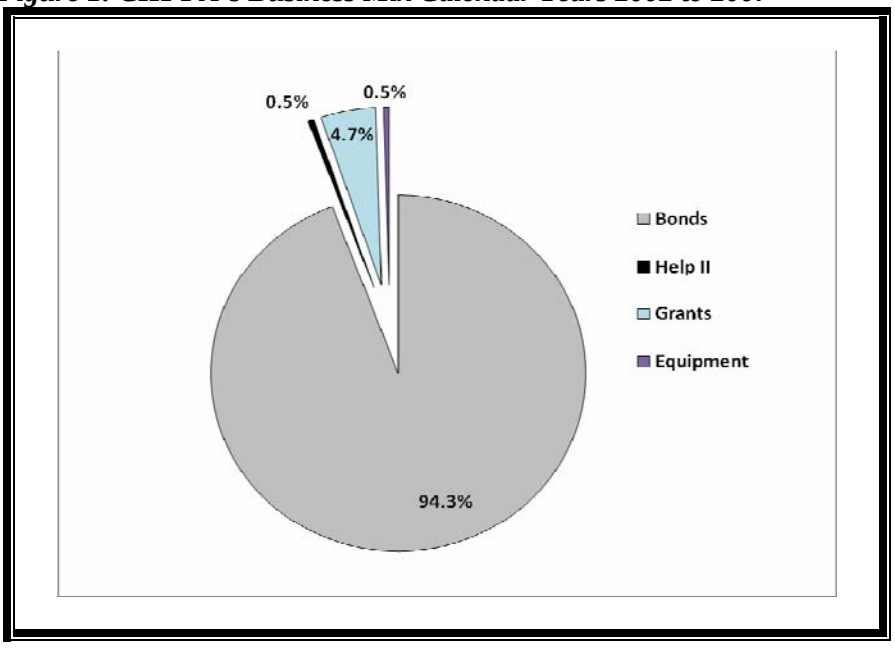
CHFFA's Financing Programs

In addition to its tax-exempt bond program, CHFFA also provides loans to small and rural health facilities through the Help II Financing Program with fixed interest loans of up to $750,000. Additionally, the Authority offers an Equipment Financing Program to purchase items including, but not limited to, medical and diagnostic equipment, computers, and telecommunications equipment. However, these programs constitute a relatively small fraction of the total annual financing activity of CHFFA as shown in Figure 1 below.

CHFFA also oversees the implementation of Proposition 61 that enabled it to issue $750 million in general obligation bonds to fund the Children's Hospital Grant in 2004. Under Proposition 61, eligible hospitals can request grant amounts between $30 million and $74 million to fund construction, renovation, and expansion projects.

However, since 2002, nearly 95 percent of CHFFA's conduit financing provided to eligible entities on an annual basis has been conveyed through the issuance of tax-exempt revenue bonds.

Figure 1: CHFFA's Business Mix Calendar Years 2002 to 2007



Source: CHFFA's Board Resolutions Calendar Years 2002 to 2007

Even though a wide range of entities are eligible to participate in CHFFA funding as allowed in statute, in reality, large hospital systems were CHFFA's primary borrowers. Over the last six years, 12 hospital systems borrowed more than $6 billion, or nearly 95 percent, of the

total $6.34 billion in tax-exempt revenue bonds issued by CHFFA during that time. Children's hospitals, although projects are financed through a different general obligation bond vehicle, captured the second largest percent of CHFFA business at $314.5 million over the same period—even though the Children's Grant Program was not created until 2004. While smaller, stand-alone hospitals used CHFFA financing for its projects, many in this category of eligible entities take other avenues to secure funding of their projects—some took advantage of CHFFA's Help II and Equipment programs that financed $66 million for entities between 2002 and 2007; other entities received financing through CHFFA competitors. Part of the reason could be that small, stand alone hospitals may not be able to meet CHFFA's bond issuance standards and, thus, CHFFA is not a viable financing option for them. Often, these hospitals will rely on the Cal-Mortgage Program operated by the Office of Statewide Health Planning and Development (OSHPD) that insures loans for health facility construction.

Scope and Methodology

In December 2007, Sjoberg Evashenk Consulting, Inc. (SEC) was selected by CHFFA to study options available concerning a possible pass-on savings requirement for the various bond-related business programs offered by CHFFA. In light of this objective, we performed a wide-variety of efforts beginning with understanding CHFFA's statutory requirements and legislative discussions surrounding the intent behind the original enabling legislation as well as subsequent amendments and an opinion on Government Code § 15438.5(a) issued by the California Attorney General's Office in November 2005. We also met with key officials of the State Treasurer's Office and CHFFA staff to gain perspective and context of historical operations and practices, various bond financing applications and programs, and operational concerns.

To analyze and consider the full complement of issues surrounding CHFFA activity and the pass-on provision for CHFFA bond programs, we conducted research and analysis of past CHFFA financed projects, identified current competitors and their practices, researched other states' fee structure, and pass-on guidelines, as well as conducted interviews with various stakeholders. We studied census data, obtained underlying documentation from the Bureau of State Audits' December 2007 report on non-profit hospitals, and researched national trends to identify the major changes and shift in the operational landscape in the health care industry since CHFFA's inception in 1979 including general cost increases, patient mix, creation of health managed organizations, and capitated rates.

In addition, we analyzed the recent Sutter transaction and pass-on arrangement approved including the methods used to quantify the pass-on amount and subsequent guidelines for implementing the savings. Using information gathered from an informal survey of member states of the National Council of Health Facilities Finance Authority, a 2007 study conducted by the Wisconsin Health and Educational Facilities Authority, and through interviews with stakeholders, we researched and queried other possible methods or elements that should be considered a benefit of using CHFFA financing and tax-exempt bond financing in general.

We conducted a wide-range of stakeholder interviews to ascertain perspectives, insights, options, and recommendations on the pass-on provision, costs of financing, applications and process, timelines and approvals, competitor advantages, CHFFA benefits, and state or federal analysis on related topics. Specifically, we met with the following stakeholders and interested parties:

- Board members
- Bond Counsel
- Underwriters
- Hospital Association and Advocacy Groups
- Rural Associations
- Employee Unions (SEIU and CNA)
- Lobbying Associations
- Private Financial Firm
- Health Care Foundations
- Large Hospital Systems
- Stand-alone Specialty Centers

Through inquiry and interview, we identified current and historical CHFFA competitors. The resulting pool was compared against a recent Office of Senate Research report on competing tax-exempt conduit bond issuers in California as well as competitors identified by CHFFA and its stakeholders.

Using a variety of documents such as Board agendas and minutes, applications, website instructions, and project-specific files as well as telephone surveys of stakeholders, we compared CHFFA activity to that of these competitors in terms of the following areas and practices:

- Bond issuance activity
- Fee structure
- Financing timeline
- Meeting schedules
- Financing criteria
- Pass-On provision
- Community benefit guidelines
- Date of incorporation
- Entry into tax-exempt bond financing market
- Other restrictions imposed on borrowers

Similarly, we compared CHFFA's provisions and financing activity to similar conduit finance entities in other states to ascertain the peer state practices, policies, and legal requirements related to pass-on provisions, community benefit guidelines, fee structure, and competition from other entities within their particular state.

As part of identifying information and statistics on CHFFA borrowers, we obtained data from California state agencies such as OSHPD, Cal-Mortgage Loan program, Department of Developmental Services, Department of Alcohol and Drug Programs, and Department of Managed Health Care. Moreover, we reviewed related statistical, financial, and utilization

data available from OSHPD such as cost-to-charge ratios, charity care expenditures, net patient revenues, and total operating expenditures. We also reviewed selected applications and financial data submitted to CHFFA for a handful of financed entities.

To better understand CHFFA's role in the community benefit arena and tax-exempt debate, we evaluated the mission and responsibilities of other related entities in the State such as OSHPD and Department of Managed Health Care. We explored federal level agencies including the Centers for Medicare and Medicaid Services, Health Care Financing Administration, and Internal Revenue Service. We also searched and studied local, statewide, and national guidance or definitions related to categories of community benefits, protocols employed to value and measure benefits, processes used to track and manage data, and methods for reporting such data including:

- National reports issued by Congressional Budget Office and Public Health Institute;
- Comptroller General testimony to the House Ways and Means Committee as well as Government Accountability Office reports;
- Guidelines suggested by Catholic Healthcare Association, American Hospital Association, and VHA, Inc.;
- Internal Revenue Service Guidelines and Comments on Return of Organization Exempt from Income Tax (Form 990) and Hospital Schedule H;
- Other States' laws and regulatory agency studies including private and public studies conducted by entities such as the Missouri Foundation for Health and the Minnesota Department of Health; and
- Annual Community Benefit Plans submitted to OSHPD by health care entities.

Results and Recommendations

Since CHFFA's inception, the tax-exempt bond financing landscape has increasingly become more crowded with the entrance of Joint Power Authorities (JPAs) into the health care tax-exempt bond market. In fact, many past CHFFA borrowers have chosen to do business with these JPAs that have developed a competitive edge over CHFFA by providing similar financing options without imposing quantified pass-on saving conditions on its borrowers—in addition to other perceived advantages cited by stakeholders.

The recent Sutter Health bond transaction accentuated differences between CHFFA and its competitors, quantified the pass-on "tax savings," and allowed much greater public input than experienced at alternative issuing JPA hearings. As a result, the unintended consequences are that CHFFA bond issue activity has stalled significantly since that transaction. While there are numerous non-profit hospital bond financing transactions being negotiated throughout California, CHFFA is not the issuer of choice and no longer the viable competitor it was previously.

With the current national debates being waged on the community benefit standards that may serve as a basis for non-profit tax-exempt status, CHFFA should allow the issue of a pass-on savings requirement to transition from its limited forum to a more appropriate broad legislative setting. Open and informed discussions can occur with stakeholders and government regulatory entities presenting their positions for added clarity regarding state and federal legal requirements. While statutes affecting CHFFA are reviewed or revised, there are several practical steps CHFFA can employ to become more competitive and allow it to continue issuing bonds for projects that have the potential to create benefits for the community at large.

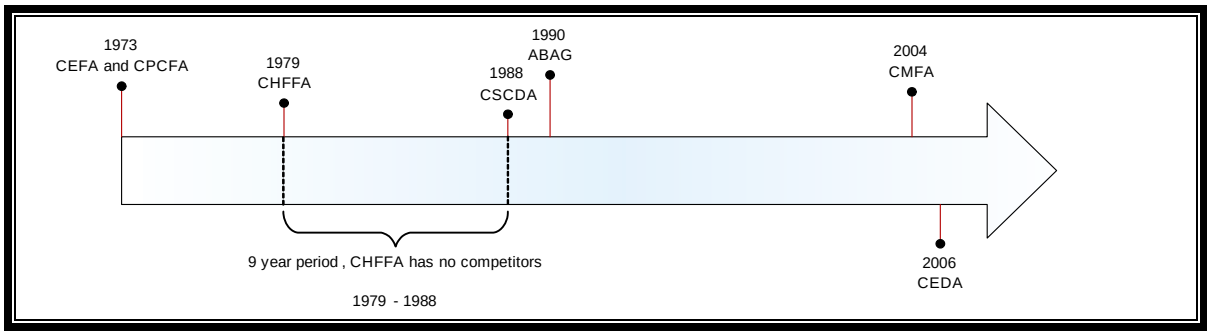
Increasing Numbers of Alternative Issuers Are Providing Competition in the Tax-Exempt Bond Financing Market

When CHFFA was created, there were only two other statewide tax-exempt bond issuers comparable to CHFFA—California Educational Facilities Authority (CEFA) and California Pollution Control Financing Authority (CPCFA), both housed within the State Treasurer's Office. Yet, because CEFA's focus was on bond issues for higher education institutions and CPCFA targeted businesses in enterprise zones or economically distressed areas, CHFFA was in essence the primary conduit financer for health care facilities in the State. Charter cities and counties were also able to issue tax-exempt bonds for health institutions—and still conduct this activity today—but, the volume and dollar value of transactions through charter cities is much less significant than the statewide reach of CHFFA.

Over the years, however, newly organized JPAs entered the bond financing market for non-profit health care providers and quickly attracted borrowers with a variety of incentives including short bond processing timeframes and attractive fees. Today, the California Statewide Communities Development Authority (CSCDA), Association of Bay Area Governments (ABAG), California Municipal Finance Authority (CMFA), and California

Enterprise Development Authority (CEDA), have emerged as CHFFA's main competitors for the bond financing business in the State. While these entities issue bonds for a wide range of projects, their recent efforts have included many health care bond financings—in essence, taking some market share away from CHFFA. Figure 2 below provides a timeline for CHFFA's competitor entrance in the bond market.

Figure 2: Timeline of Conduit Financers Entrance Into Tax-Exempt Bond Market



Source: Senate Office of Research Report on "Comparison of Bond Issuing Authorities," February 2008

Each of the other entities issue bonds for projects proposed by non-profit health care organizations as well as other types of projects in areas such as education, industrial development, housing, and environmental quality. However, more recently, these competitor JPAs have been accelerating the volume and dollar amounts of their bond issues in the health care market. For instance, while CSCDA was created in 1988, its first health care bond was not issued until 1991. Similarly, ABAG was established in the early 1960s and focused primarily on the economic development of the San Francisco Bay Area—but, ABAG's emergence as a finance authority for non-profit corporations was not until 1990.

The changes to the tax-exempt bond financing market with alternative financing options made available to borrowers by JPAs are externalities beyond the control of CHFFA—a market that once had been the exclusive purview of CHFFA is now accessed by borrowers through several other competitive issuers. Moreover, that market may get even more crowded in the future with the advent of multi-state issuing authorities. Currently, nine states had their charters amended to give them multi-state powers allowing larger health care providers operating in more than one state to issue all of their debt through one of these multi-state facilities. The streamlined nature of the review and approval process of these multi-state issuers give them the ability to leverage resources to process more transactions, according to a March 2007 newsletter issued by the National Council of Health Facilities Finance Authorities. If this trend continues, it could prove problematic for single state conduit issuers, such as CHFFA, that could lose the opportunity to fund hospitals residing in their states—especially if health care consolidation by large providers continues.

Pass-On Savings Quantification and Uncertainty Discourages Borrowers

In addition to the differences between CHFFA's sole health care focus and the variety of projects funded by its competitors, there is another significant nuance between the entities in terms of a pass-on statute placed on CHFFA activity and not on that of other JPAs. CHFFA statutes specifically state that "all or part of any savings experienced by a participating health institution, as a result of that tax-exempt revenue bond funding, be passed on to the consuming public through lower charges or containment of the rate of increase in hospital rates." However, none of the other JPAs in California are subject to this provision. While several of the JPA applications call for a description of the "public benefit" derived from the project, there is no statutory intent language placed over their operations—resulting in a potential advantage over CHFFA.

This advantage was exacerbated when Sutter Health submitted a bond application to CHFFA on November 1, 2006 requesting nearly $958 million of bond financing to fund capital improvement projects at six Sutter network facilities across Northern California and the Central Valley. These projects included seismic retrofitting of the Mills-Peninsula Health Services and the California Pacific Medical Center-Davies, as well as expansion of the Sutter Roseville Medical Center, Memorial Medical Center, Sutter Amador Hospital, and Sutter Gould Medical Foundation. Based on staff recommendation for approval of the bond, the issue was heard by the CHFFA Board at its regular meeting on December 7, 2006. At that meeting, representatives from the Service Employees International Union (SEIU), California Nurses Association (CNA), Family Doctor Medical Group, and California Health Care Coalition joined forces to voice their concern that Sutter Health was not satisfying the pass-on requirement pursuant to Government Code Section 15438.5(a) and, thus, not fully extending the benefits derived from tax-exempt bond financing to the community.

Acknowledging the public comments, the Board chose to postpone its decision on the Sutter Health bond deal until its hearing the following month in January 2007 in order to further research governing statutes. With CHFFA staff finding that its statutes did not specifically quantify the amount of the intended pass-on, the Board set out to calculate the potential savings amount for the Sutter transaction and impose a pass-on savings amount as condition of approval. With these actions, the CHFFA Board was inadvertently thrust into the middle of the long-standing national dialogue and study on community benefit provisions and non-profit hospitals accountability in providing charity services to the broader community.

To best address public concerns raised about the Sutter Health non-profit hospital network not passing-on a "fair share of savings" to the community, several independent studies were conducted to quantify the savings and calculate a pass-on amount related to the bond deal. Three separate entities—CHFFA, Sutter Health, and SEIU—embarked on the effort and arrived at different saving amounts. Similarly, each calculation did not consider the availability of tax-exempt financing from other JPAs. The difference between the taxable financing method and the tax-exempt method was determined to be the savings amount.

However, the application of this criterion resulted in three different proposed pass-on amounts as shown on the following page:

- Sutter: $ 6.5 million per year
- CHFFA: $ 8.5 million per year
- SEIU: $14.3 million per year

As there is no general standard for calculating the pass-on savings amount, the entities considered varying factors in their calculations which explains the wide-spread resulting amounts. For instance, Sutter used the U.S. Treasury as the benchmark for calculating the annual interest cost. However, as U.S. Treasury interest rates are usually lower than regular corporate bond rates that were applied in CHFFA's and SEIU's calculations, the benefit amount of the tax-exempt financing changes depending on the criteria used. But even with the use of corporate bond rates as comparison, the amounts can differ due to factors such as length of financing and market rates for tax-exempt and taxable bonds at closing. Ultimately, at its March 2007 meeting, CHFFA quantified and Sutter Health committed to a quantification of the pass-on amount valued at $8.5 million to be distributed in the form of cash grants to the community—specifically to rural hospitals, health information organizations, and other healthcare facilities outside of Sutter Health's network.

In the final analysis, the quantification of the pass-on savings amount and public discussion of the merits of a health care organization's contribution of benefits to the community resulted in an immediate and unintended effect on CHFFA. Employee unions and other groups felt the pass-on amount did not constitute a significant financial burden to a large health care provider like Sutter Health, while others felt it was unreasonable or a "tax" imposed on hospitals. For borrowers and underwriters, the aspect of additional unknown costs for a pass-on amount associated with CHFFA financing was a "deal breaker"—a perspective immediately felt by the Authority when no borrowers submitted applications to CHFFA for a five-month period subsequent to the March 2007 Sutter Health bond approval, and only three lower dollar value bond applications came to CHFFA over the subsequent four-month period that year.

In our survey of more than 18 stakeholders ranging from bond underwriters and advocacy associations to large hospital systems and stand alone specialty centers, many participants shared similar fears associated with the quantification of the pass-on savings amount imposed on Sutter Health and cited the issue as a key factor influencing them to leave CHFFA and use other tax-exempt competitors for project financing. Specifically, this was mentioned by most of the stakeholders interviewed. Some disagreed with the notion in concept as their perspective was that non-profits existed to provide benefits to the community as part of their core mission, philosophy, and operations.

- ✓ **Stakeholder hospitals, associations, and underwriters stated the quantification of the pass-on provision will drive them to CHFFA competitors**
- ✓ **These same stakeholders expressed concerns related to the unrelated Board and public inquiries**

A secondary factor cited by several of the stakeholders for the exodus from CHFFA toward other financiers was the public inquiry and comments unrelated to the projects before the Board for approval. Several mentioned that beginning in 2005, long discussions by Board members and the public on non-application issues that were unexpected and for which they were not prepared to respond, including inquiries related to employment practices and price charging. One underwriter mentioned its clients expect questions from the Board or public

related to proposed projects as well as credit worthiness and the ability to repay the debt; however, some inquiries, in their opinion, had no bearing to the transaction before the Board such as questions raised in relation to billing practices or labor negotiations.

We did not find that CHFFA had bylaws or meeting guidelines detailing the protocols regarding the time allotted for the public comment period—as well as time allotment for borrowers themselves—or what constitutes the appropriate focus and nature of the comments on the bond issuance at hand. Nor did we identify any procedures regarding obtaining written public comments in advance of the hearing. However, numerous stakeholders asserted that fewer questions and unrelated comments are made during board meetings at alternative JPAs, which they believe allowed for a more efficient application processing.

In interviews with large hospital systems and small specialty centers, health care associations, underwriters, and bond counsel, stakeholders made it apparent that borrowers would not return to CHFFA unless the following conditions were addressed—specifically, they want CHFFA to:

- Clearly define a pass-on provision that **does not** generate or result in financing costs higher than those charged by competing JPAs; and,
- Better manage and focus its inquiries and commentary as well as those of the public to the merits of the proposed facility project(s) or the creditworthiness of the borrower.

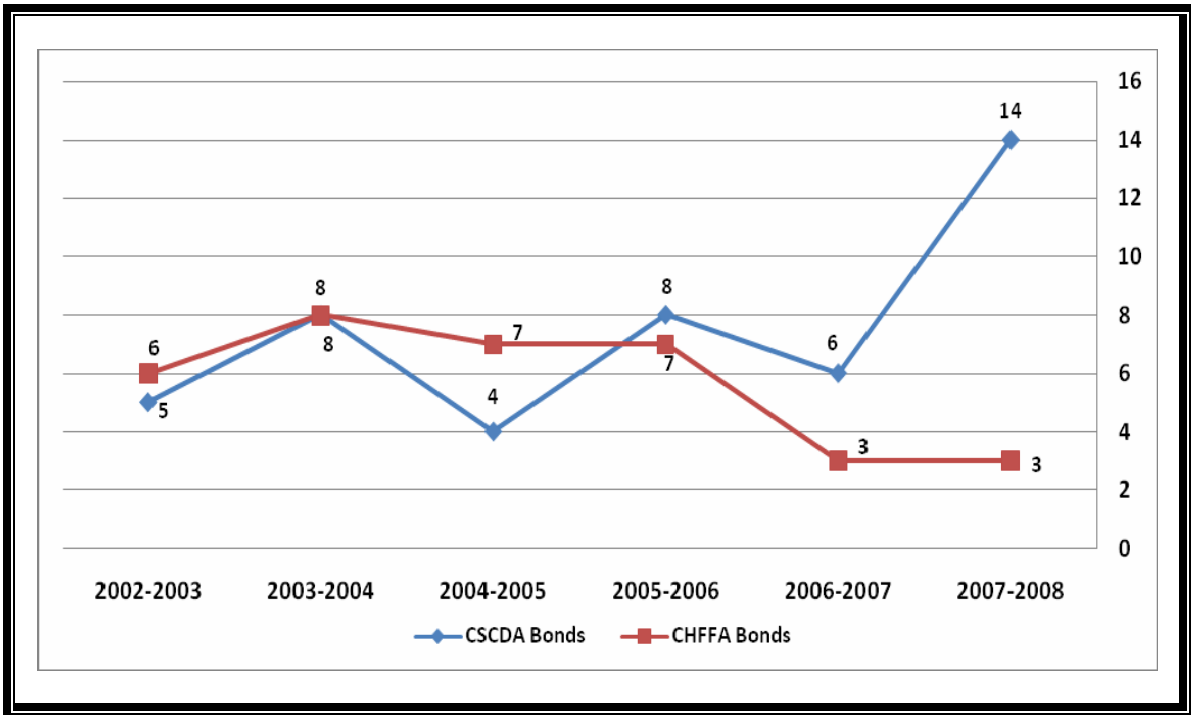
Without these terms being met, CHFFA will continue to see a decline in bond financing applications.

CHFFA Has Lost Its Market Share, While Bond Financings Throughout the State Remain Strong

While the Sutter Health agreement was well-intentioned to increase levels of community benefits from projects financed by the Authority, the precipitous decline in CHFFA bond applications and related issuances had a devastating effect. Unfortunately, the resulting reduction in CHFFA's business, or market share, is occurring despite the fact that hospital tax-exempt bond financing remains robust throughout California.

In the past, CHFFA had enjoyed a strong market presence in the periods prior to the Sutter Health transaction approving an average 6 bond issuances annually between April 2002 and March 2007—but, that activity experienced an abrupt change as the pass-on saving discussion and negotiation ensued. As shown in Table A on the following page, annual bond issuances dropped to three issuances in the April 2006 to March 2007 time period and remained at three issuances for the subsequent period. Moreover, the related dollar value of these three recent bond issuances was not at levels seen prior to the pass-on savings quantification as shown in Table B presented on page 15.

Table A: Number of CHFFA & CSCDA Bonds Approved from April 2002 to March 2008*



***To date, through February 2008**

***Source:** CHFFA Board Meeting Minutes from 2002 to 2008 on CHFFA's website*
Bond Issuance Data provided by CSCDA's Program Manager

***Note:** CSCDA data for the 2007-2008 period only available from April 2007 through December 2007*

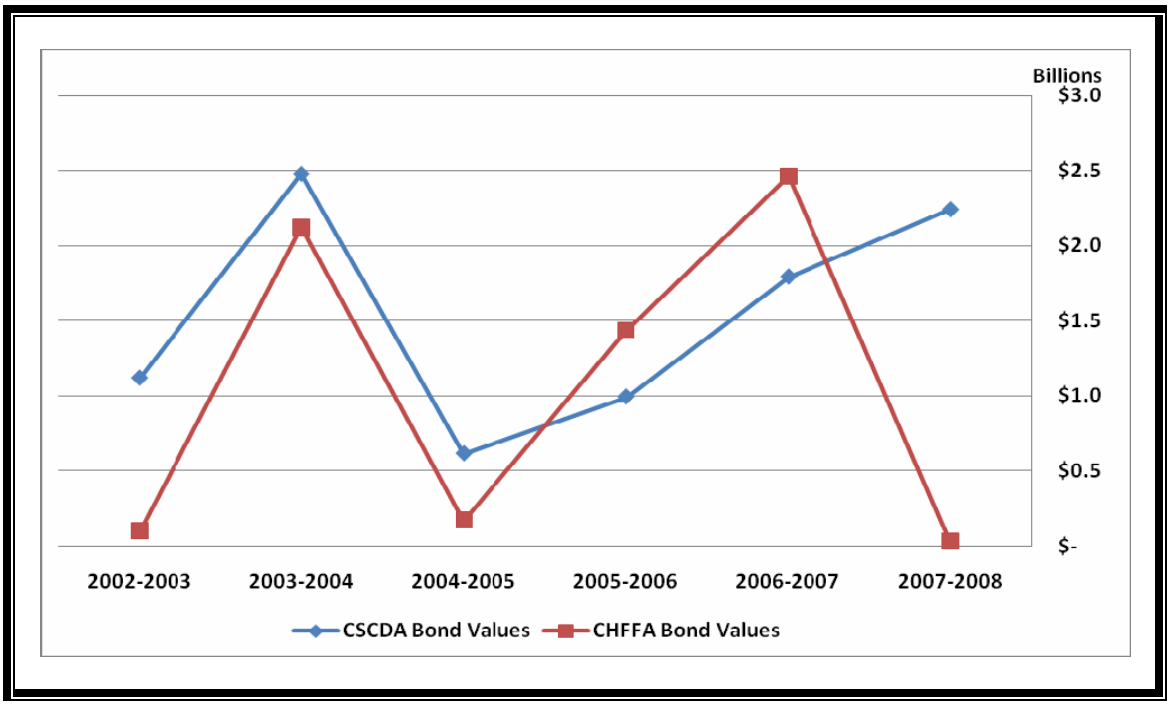
In contrast, as bond issuances continued on a declining trend for CHFFA, volume generated by its primary competitor skyrocketed to record numbers. CHFFA's primary challenger for business, CSCDA, approved 14 hospital bond issuances during the April 2007 to December 2007 time period alone—more than double its previous year's amount. Moreover, according to CSCDA data, those 14 issuances funded more than 72 hospital projects versus CHFFA's 3 bond issuances during the same timeframe that only equaled to 4 hospital projects.

While volume of issuances is certainly one measure of the strength of CHFFA's business, the dollar amount of bond financing conducted by CHFFA in the last year provides a more revealing depiction. Specifically, over the 11 months since the Sutter Health transaction, CHFFA only provided $27 million of tax exempt bond financing—in stark contrast to the $1.1 billion per year it had averaged since 2002.

As shown in Table B on the following page, while its value of conduit financing activities has fluctuated since April 2002, CHFFA started to experience a significant growth in activity during the April 2003 to March 2004 timeframe. In the April 2004 to March 2005 period, financing provided was not as robust, but the following two periods were strong with financings reaching an all-time high of more than $2 billion in the 2006 to 2007 period. Yet, in the following period, CHFFA financing all but stopped with only $27 million dollars in approved bond applications. At the same time, CSCDA's bond issuance volume remained high in 2007 with $2.2 billion for non-profit hospital bond activity alone as shown in Table B

below. Moreover, CSCDA's financing is experiencing an overall growth trend in the last few years.

Table B: Value of CHFFA & CSCDA Bonds Approved From April 2002 to March 2008*



****To date, through February 2008***

***Source:** CHFFA Board Meeting Minutes from 2002 to 2008 on CHFFA's website*
Bond Issuance Data provided by CSCDA's Program Manager

***Note:** CSCDA data for the 2007-2008 period only available from April 2007 through December 2007*

According to a recent Senate Office of Research report, even a new competitor to CHFFA—the California Municipal Finance Authority (CMFA) that has only been in business since 2004—has already claimed $500 million of the bond market, or 26 percent of CHFFA's 2006 bond volume. At least $320.6 million of CMFA's issuances was related to projects for community medical centers in May 2007.

CHFFA's declining bond finance trend seems unlikely to change in the near future given the broad-based concerns we heard from stakeholders and borrowers. In interviews with large hospital systems and small specialty centers, health care associations, underwriters, and bond counsel, these various stakeholders made it clear that borrowers were unlikely to return to CHFFA unless specific actions were taken.

Other Concerns Lead Borrowers to Favor CHFFA Competitors

Compounding the issues surrounding the quantification of the pass-on provision and public inquiry protocols, there were additional factors that influenced stakeholder decisions to take their business to CHFFA competitors. Specifically, stakeholders mentioned longer timeframes and unnecessary delays, rigidness of Board meetings, and cumbersome

applications as some of the other concerns discouraging borrowers from returning to CHFFA in the future.

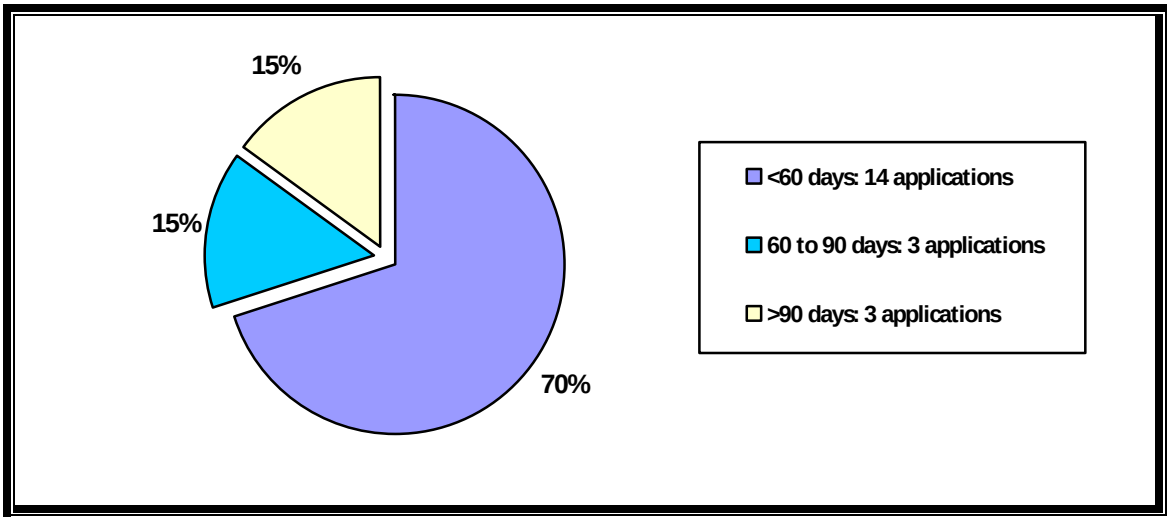
CHFFA's Approval Process Appears to Take Longer than Competitors

As seen with the Sutter Health transaction, the CHFFA bond approval process can be delayed by months due to increased public scrutiny and the Board's diligence in considering all public comments. Additionally, while CHFFA is bound by public meeting requirements that are slightly more restrictive than faced by its competition as discussed in a subsequent section of this report, at least two stakeholders commented that the CHFFA process can generally take at least 30 days longer than its competitors.

Quicker timelines could be partly attributed to CHFFA competitors' offering of ad-hoc meetings tailored to the needs of the applicant—in some instances, the applicant is even heard within 24 hours of submitting the application to other JPAs according to certain stakeholders. In contrast, applications submitted to CHFFA are generally heard at the next scheduled Board meeting, which could be as long as one month in length if the application was submitted the day after the last Board meeting.

Our analysis of 20 bond applications CHFFA approved between 2002 and 2007 corroborated the type of delays described by stakeholders as shown in Figure 3 below. Of the 20 applications, most were approved by the Board within 60 days of submission. Three applications were approved between 60 and 90 days after submission—moreover, another three applications took nearly five months to approve. Considering the larger pool of all conduit issuers, several stakeholders mentioned that it typically takes two months to complete bond financing process.

Figure 3: CHFFA's Timeframe From Application Submission to Board Approval



Source: CHFFA Bond Issues and Board Minutes from Calendar Years 2002 to 2007

One of these delayed applications was related to the Sutter Health bond issue that took 149 days to approve. Although the arrangement was initially brought to the Board for approval in December 2006, numerous concerns voiced by union and health care groups prompted the

Board to delay its decision on the issue until January 2007. As the issues were still not resolved when January arrived, the Board again deferred its approval until March 2007 when the financing deal was eventually sealed after being discussed for nearly five months. All in all, applicants experienced a range of approval timelines from CHFFA ranging from 23 days to nearly 150 days for bond approval. Because time is of essence for starting planned projects and optimally capitalizing on favorable financial market conditions, several borrowers told us they prefer CHFFA competitors where timelines associated with the approval process are more consistent.

Competitors are More Flexible than CHFFA with Public Meeting Schedules

As with boards of other public entities, the CHFFA Board is bound by public meeting rules and requirements that call for meeting notices, resolutions to be discussed, and agendas to be published on the website well in advance of the meeting. The CHFFA Board, like its competitors, holds regular board meetings to hear proposed financing packages, weigh the merits of each application, and decide on the outcome of the planned bond issue.

As a state-level authority, CHFFA follows the provisions of the Bagley-Keene Open Meeting Act as codified at Government Code Section 11125 (a) requiring state-entities to provide public notice at least 10 days in advance of a scheduled meeting. Information on the proposed bond issuance is publicly posted on CHFFA's website at least 10 days in advance of monthly meetings as part of the Authority's agenda package. In contrast, the Ralph M. Brown Act (codified at Government Code Section 54950) is applicable to local agency JPAs and only requires a 72-hour notice of a Board meeting and provision of an agenda. Thus, inherently, CHFFA is held to a stricter and lengthier public notice process.

However, there is no language in the Bagley-Keene Act restricting the frequency of CHFFA meetings. Currently, CHFFA meetings are held once a month during which the public is invited to ask questions and voice any concerns over a health care provider's application. But this was cited as another disadvantage associated with CHFFA as its competitors seem more willing and flexible to hold more frequent ad-hoc meetings outside of the established schedule for board meetings. For example, we were informed that one competitor—ABAG—will schedule board meetings as soon as an application is received. While this type of flexibility may be difficult to achieve depending on the volume of applications, it certainly provides a benefit of using that competitor.

Not only are CHFFA Board meetings no more frequent than monthly, but we heard complaints that board meetings had been cancelled and delayed to the following month. During the 2002 to 2007 timeframe, it appeared that CHFFA had cancelled 17 of 72 hearings—or nearly 24 percent of all scheduled hearings. According to some stakeholders, a one-month delay can generate devastating impacts on financing costs associated with the bond issuance as well as on ever-escalating construction costs. At the same time, other stakeholders felt that a one-month delay was insignificant in the grand scheme to ensure the public benefit merits of a particular bond issue submitted for approval is clear and measurable.

At one point in CHFFA's history, it held a clear advantage with larger hospital system borrowers in that CHFFA was considered a one-stop shop for required Tax Equity and Fiscal Responsibility Act (TEFRA) hearings. These public TEFRA hearings are designed to allow interested persons an opportunity to express their views for or against the issuance of the bonds. If a borrower seeks financing for several projects scheduled for construction throughout several cities, it is required to hold a separate TEFRA hearing in each city where the projects are proposed. As a statewide issuer, using CHFFA allows borrowers to hold one TEFRA hearing that covers all proposed projects. However, stakeholders and borrowers feel that this benefit is outweighed by the other advantages of using CHFFA competitors—including the more flexible, as-needed basis meeting schedules offered by CHFFA competitors. Moreover, several stakeholders praised competitors' efforts and resourcefulness in coordinating the required multiple TEFRA hearings on behalf of the borrowers to facilitate the financing process. One stakeholder indicated that city councils and other TEFRA participants often meet weekly or bi-weekly, so separate TEFRA hearings do not necessarily add noticeably significant time to the process.

CHFFA's Application is More Cumbersome Than Competition

Although a minor point when mentioned by stakeholders, we were informed that, in addition to the other concerns they have with CHFFA, the application itself is cumbersome and lengthier than its competitors. While nearly all conduit issuer applications have similar and clearly necessary informational requests such as detailed project descriptions and financing information, CHFFA clearly requests much more data and effort from its borrowers. One convincing example is that CHFFA's application alone is 34 pages long, whereas its competitors' applications are no more than 4 pages.

For example, borrowers interested in CHFFA financing must also respond to and submit other information such as a community service certificate, environmental quality review, religious affiliation questionnaire, and legal status questionnaire. Additionally, applicants must provide certain inpatient and outpatient utilization statistics including breakdown of visits by emergency, surgery, and other categories as well as admission volume data including bed occupancy and average length of stay. Further, CHFFA requests detailed breakdowns of patient revenue by source such as Medicare, Medi-Cal, commercial, and private pay, as well as percentage of revenue associated with inpatient and outpatient elements—most, if not all, being data that is captured and available publicly from the California Office of Statewide Health Planning and Development. In contrast, none of CHFFA's three main competitors require the extra submissions as shown in Table C on the following page.

Table C: Comparison of CHFFA Application Criteria with Its Primary Competitors

	CHFFA	CSCDA	ABAG	CMFA
Application Criteria:				
Application Length (pages)	34	4	2	3
Ability to Submit Online		X		
Application Details:				
Applicant Information	X	X	X	X
Project Description and/or Feasibility Study	X	X	X	X
Project Timeline	X		X	
Financing Information	X	X	X	
Finance Team Profile	X	X	X	
Public Benefit Description	X	X	X	X
Detailed Source and Use of Funds	X	X	X	
Project Cost Detail				X
Financial Reports	X	X		X
Project Jurisdiction Information		X	X	X
3-year Financial Outlook	X			
Pass-on Savings Description	X			
Legal Status Questionnaire	X			
Religious Affiliation Questionnaire	X			
Utilization Statistics	X			
Community Service Certificate	X			
Cost Savings Analysis	X			
Environmental Quality Act Review	X			

Source: Applications for CHFFA, CSCDA, ABAG, and CMFA available on organizations' websites.

Not only is the CHFFA application longer and requests more data from a potential borrower, but clearly, the nature of the data required is much more complicated and cumbersome. While competitors' applications seem to allow for more narrative descriptions from the potential borrowers, CHFFA is more prescriptive in the specific information requested. For instance, CHFFA requires borrowers to provide a cost savings analysis with the following four elements—debt service savings by year, total savings, net present value of total savings, and the ratio of net present value to the par amount of the new debt. While that request is related to the requested bond issue, the direct relevance of other application requests is more tenuous. One example relates to the religious affiliation due diligence questionnaire that must be completed by applicants with inquiries related to admission policies, hiring guidelines, and employment practices—items entailing data such as the percentage of a facility's staff that is of the same religious affiliation as the facility and percentage of patients that are of the same affiliation. Further, CHFFA requires written evidence for each response.

While additional data might also be requested by CHFFA competitors at some stage of the process before the bond financing is formally approved, the applications themselves are certainly less complicated with the alternatives JPAs.

While it is Less Expensive than its Primary Competitor, CHFFA's Fees Are Higher than Other Competitors

In 1979 when CHFFA was created, there were no statewide avenues available for non-profit health care entities to seek tax-exempt financing other than CHFFA. However, as the market has changed and more competition exists for tax-exempt conduit financing, borrowers are concerned with the fees charged by authorities as part of bond financing. Stakeholders we interviewed indicated that the fee amount is not the only decision-making factor; yet, our comparison of fees between CHFFA and its three main competitors revealed that CHFFA is not always the most economic financing option. While its fees are higher than some issuers, CHFFA was similar to or slightly less expensive than its primary competitor CSCDA.

It is important to note that when CHFFA's operating fund balance grew in the past, it transferred funds to its grant program—thus, utilizing a portion of its fee revenues to support worthy community benefits.

Each of the conduit issuers we reviewed charged the same type of fees—typically, an application fee, initial or issuance fee, and annual administrative fee. While CHFFA charges the lowest application fee at $500 with its competitors ranging from $1,000 to $5,000, CHFFA is often more costly than some competitors in the issuance fee and annual administrative fee areas where the major costs of a financing deal are incurred.

For instance, we found CHFFA to be the least expensive option for financing amounts worth less than $1 million. Based on our calculations for a $1 million bond issue, the financing would cost the borrower a total of $1,450 with CHFFA—compared to $16,850 with CSCDA as shown in Table D below. However, with no bond financings since 2002 valued at amounts less than $1 million, CHFFA's fee advantage may be irrelevant.

Table D: Fee Comparison for Financing Amount of $1 million

	Costs				
Authority	*Application Fee*	*Issuance Fee*	*Annual Admin Fee*[(1)]	*Other Misc. Fees*	**Total Costs** (one-time)
CHFFA	$500	$750	$200	$500	**$1,450**
CMFA	$2,500	$2,000	$150	n/a	**$4,650**
ABAG	$1,000	$5,000	$200	n/a	**$6,200**
CSCDA	$2,500	$14,350	$300	n/a	**$16,850**

Note: [(1)] These fees would be paid annually as long as the bonds are outstanding.

Source: Amounts calculated using CHFFA Bond Application and Fee Schedule, CSCDA "Fee Schedule," CMFA "Schedule of Fees," and ABAG "Transaction Costs" listed on competitor website

But for amounts in the $10 million, $100 million, and $1 billion dollar ranges—where CHFFA issued 21 bonds including two bonds worth more than $1 billion since 2002—CHFFA financing is not always the least costly option. In fact, based on our calculations for a $100 million bond deal, CHFFA is more expensive than two of its competitors although it is less expensive than CSCDA as shown in Table E on the following page.

Table E: Fee Comparison for Financing Amount of $100 million

	Costs				
Authority	*Application Fee*	*Issuance Fee*	*Annual Admin Fee*[1]	*Other Misc. Fees*	**Total Costs** (one-time)
CHFFA	$500	$75,000	$20,000	$500	**$95,500**
ABAG	$1,000	$25,000	$10,000	n/a	**$36,000**
CMFA	$2,500	$75,000	$15,000	n/a	**$92,500**
CSCDA	$5,000	$80,000	$30,000	n/a	**$115,000**

Note: [1] These fees would be paid annually as long as the bonds are outstanding.

Source: Amounts calculated using CHFFA Bond Application and Fee Schedule, CSCDA "Fee Schedule," CMFA "Schedule of Fees," and ABAG "Transaction Costs" listed on competitor website

Finally, for a $1 billion bond financing, CHFFA again is only second to the most expensive issuer CSCDA. Although CHFFA financing costs are less than CSCDA at this level, CHFFA's fees are significant when compared with its other two competitors CMFA and ABAG. Actually, it will cost borrowers twice as much for a $1 billion bond with CHFFA compared to CMFA and 12 times more than with ABAG as shown in Table F below.

Table F: Fee Comparison for Financing Amount of $1 Billion

	Costs				
Authority	*Application Fee*	*Issuance Fee*	*Annual Admin Fee*[1]	*Other Misc. Fees*	**Total Costs** (one-time)
CHFFA	$500	$300,000	$150,000	$500	**$450,500**
ABAG	$1,000	$25,000	$10,000	n/a	**$36,000**
CMFA	$2,500	$75,000	$150,000	n/a	**$227,500**
CSCDA	$5,000	$530,000	$200,000	n/a	**$735,000**[a]

Source: Amounts calculated using CHFFA Bond Application and Fee Schedule, CSCDA "Fee Schedule," CMFA "Schedule of Fees," and ABAG "Transaction Costs" listed on competitor website

Note:[1] These fees would be paid annually as long as the bonds are outstanding.

Note:[a] Although CSCDA's Fee Schedule has not been changed, Mike LaPierre (Program Manager, CSCDA) stated that it has been the policy of the CSCDA to cap its issuance fee at $300,000 for healthcare financings over the last two years as indicated through two recent financings with Kaiser Permanente and Catholic Healthcare West. Thus, a $300,000 issuance fee cap would result in total CSCDA costs of $505,000 for a $1 billion financing.

With more serious competitors crowding the bond financing market, all of the factors discussed in the above sections combine to put significant pressure on CHFFA. Challenges such as longer bond approval timelines, cumbersome applications, and CHFFA's fee structure for large-scale bond financings have made it difficult for the Authority to stay at the forefront of the tax-exempt bond financing market in California. Most notably, the quantification of the pass-on provision as part of the Sutter Health transaction has, in essence, taken CHFFA out of the market almost entirely.

While stakeholder issues and concerns surrounding the pass-on debate remain critical and far-reaching, none of them will have any consequence if CHFFA does not remain in business to issue bonds. The significant lost fee revenues associated with the issuance of a bond place CHFFA's operations at risk. For instance, one single $1 billion bond issuance would generate $450,500 in fees for CHFFA during the first year of the issue. Until CHFFA changes to regain its market share, these revenues will flow to its competitors. Thus, unless

CHFFA takes swift action to recover its lost clientele, there will be no potential benefits at all to "pass-on" to the community from its financed projects.

Pass-On Debate Should be Addressed by the Legislature

Over the nearly 30 years since the California Health Facilities Financing Authority Act established CHFFA, the health care environment has undergone significant changes that greatly affected the tax-exempt bond market, non-profit entities, and community benefits in general—yet, several constants remained related to concerns on quality, costs, and access. Congress took a number of incremental measures such as the passage of the Health Maintenance Organization (HMO) Act of 1973 and establishment of managed care organizations that helped stabilize health care costs for a period of time. Yet, once again, health care costs began to escalate as did the spotlight on community benefits.

One area of national and local scrutiny was to make non-profit hospitals more accountable in terms of what they provide to their communities to remain exempt from paying property taxes. At the forefront of this challenge to the tax-exempt status of hospitals is the argument that many non-profit entities receive more benefits than what they provide in charity care or other community benefits. Statewide and national discussions are being held across the country to examine and deliberate this issue including hearings before the U.S. House of Representatives' Ways and Means Committee, tax form revisions by the Internal Revenue Service, and legislative and attorney general reviews in several states. While financing authorities throughout the country may be weighing in on the matters at hand, the final deliberation and outcomes are being addressed in more appropriate forums—their respective legislative bodies.

Clarification of Pass-On Should be Moved to Different Arena

CHFFA was established as a "public instrumentality" with a purpose of facilitating tax-exempt bond financing for those public and non-profit health care providers in California that can demonstrate the financial feasibility of their projects. Statutes also included intent language that all or part of any savings experienced by a participating institution, as a result of the bond funding, is passed-on to the consuming public. In November 2005, the Attorney General provided additional insight into the legislation and opined that "the absence of a concrete 'requirement' and of any related guidance leaves CHFFA with the discretion to implement the Legislature's broad goal as it sees fit within the parameters of the Act."

In the past, CHFFA implemented the pass-on provision through its application process and request for a description of how the borrower intended on passing-on savings resulting from the proposed financing. Borrowers' responses to this question as well as other items on the application were analyzed by CHFFA staff and deliberated by the Board. An optional section in the application also allowed for applicants to submit a summary of additional community service—beyond service required by law—provided by the health care facilities with examples of the types of services provided and the relative costs as a percentage of total revenue. Then, in 2007, CHFFA was motivated to quantify the pass-on savings on the Sutter Health facility financing. But, as discussed earlier in this report, that transaction created

unintended consequences on CHFFA's business. Moreover, with such actions and focus, CHFFA became lodged in the center of the complicated decades-long debate on the merits of tax-exempt status, as well as how preferential benefits derived should be reinvested in the community. Although it had good intentions, the Authority's attempts to quantify pass-on benefits accentuated the competitive advantages of alternative JPS issuers. Even CHFFA's closest competitor acknowledged its entity has only a limited role in community benefits when it proposed and approved benefit guidelines with respect to bond financing. Specifically, CSCDA's guidelines and recommendations stated they were reflective of "CSCDA's limited role as a conduit issuer of bonds that has no administrative or regulatory authority in the labor and business practices of California health care providers."

Currently, there are other state and federal agencies functioning as regulatory authorities over the operational practices and tax-exempt activities of health care providers such as the California Office of Statewide Health Planning and Development (OSHPD), the federal Internal Revenue Service (IRS), and the U.S. Health Resources and Services Administration (HRSA). For instance, the IRS is responsible for ensuring the compliance of non-profit hospitals and other entities, enforcing laws to ensure entities meet their tax obligations, and investigating abuses of tax-exempt organizations. According to the IRS, their efforts include "an enhanced examination program, stricter scrutiny in our application process, and partnering efforts with the state attorney general and the Federal Trade Commission" as well as "revoking tax-exempt status where warranted." Additionally, in California, OSHPD is responsible for developing hospital uniform accounting and reporting provisions, gathering financial data, and reviewing that data. By statute, all hospitals in California must implement and use the OSHPD-prescribed hospital uniform accounting system in their records on a day-to-day basis.

Moreover, in 1994, the Governor of California signed Senate Bill 697 into law noting that public recognition of the unique status of private not-for-profit hospitals meeting certain needs in the community has led to favorable tax treatment by the government. Legislation also described that hospitals and the environment in which they operate have undergone "dramatic changes" and that there would be significant public benefit from having these hospitals reaffirm their commitment to assist in meeting their communities' health care needs by identifying and documenting benefits provided. Towards this end, legislation was enacted requiring a community benefits plan to be submitted annually by these hospitals to OSHPD and mandated these plans contain measurable objectives to be achieved related to medical care services, benefits for vulnerable populations, benefits for the broader community, health research and education, and nonquantifiable benefits.

Combined, the efforts of these governmental entities make the pass-on provision a situation best addressed in Congress and the California Legislature.

Benefits of Using CHFFA Financing Are Not Clearly Discernible

In general, the tax-exempt business environment is different than it was in 1979 when intent language was incorporated into CHFFA's statutes. When CHFFA was the primary conduit bond issuer for health care entities, borrowers derived a benefit between the costs of a tax-exempt financing and those costs that would have been incurred in the conventional taxable

market. Depending on the rates on any given day, the savings experienced through tax-exempt financing could be substantial. However, the benefits of using CHFFA are not as clearly discernible as they were 30 years ago. While traditional financing is still an option for borrowers, increased competition in the tax-exempt bond market has provided borrowers with more options. In today's environment, a non-profit hospital may not experience a benefit at all from using CHFFA since equal or better terms can be obtained from competing JPAs. Consequently, the original concept that using CHFFA's uniquely generated savings from tax-exempt debt versus conventional borrowing is an outdated premise.

However, when CHFFA quantified the pass-on savings in the Sutter Health transaction, it set a higher or more rigorous standard than used by the other JPAs. This resulted in borrowers going to alternate JPAs where a benefit calculation and pass-on provision are not requirements they face. Currently, the other JPA competitors only require a simple statement from the borrower describing the public benefit associated with the project or more comprehensive summary of the project public benefits—further, these are qualitative descriptions and not quantifiable requirements. As an inadvertent result, CHFFA is no longer operating on a level playing field where all issuers must adhere to a similar set of requirements.

Unless all conduit issuers—not just CHFFA—are mandated to assure that pass-on benefits are shared with the community, this dichotomy will continue. With CHFFA's narrow authority applicable only to its own financing activities, it cannot mandate standards and provisions to be imposed on the other JPAs and it is placed at a significant disadvantage. To address this dilemma, the most practical solution for CHFFA is to move the debate out of its limited forum and into a more deliberative arena where all relevant parties and stakeholders can bring forth their perspectives and recommendations—including government and regulatory agencies charged with responsibilities specifically associated with the health care and tax-exempt areas.

Current Statutes Provide Community Service Definition

While waiting on outcomes on the federal front or clarification of State statutes, other sections of CHFFA's statutes could provide the Authority with a mechanism to exercise a clearer definition of community service without stepping away from legislative intent. Specifically, Government Code Section 15438.5(c) states that "a health facility that performs a significant community service is one that contracts with Medi-Cal or that can demonstrate, with the burden of proof being on the health facility, that it has fulfilled at least two of the four following criteria" summarized below:

1. Maintain a 24-hour emergency service;
2. Adopt a policy of treating all patients without regard to ability to pay;
3. Provide care to Medi-Cal and uninsured patients (over the life of the bond) in an amount not less than five percent of the facility's adjusted inpatient days as reported to OSHPD; and
4. Budget at least five percent of net operating income to meet medical needs of uninsured patients and to provide services such as community education, primary care

> outreach in ambulatory settings, and unmet non-medical needs of food, shelter, clothing, or transportation for the vulnerable populations in the community.

Further, mandates under Government Code Section 15438(a) give CHFFA the authority to "adopt bylaws for the regulation of its affairs and the conduct of its business." Since CHFFA is given broad authority in the Attorney General's opinion, it could establish its own definition regarding the "pass-on" issue. Thus, the above definition of community services could be incorporated or modified into its bylaws until more clarity is provided from the Legislature. Moreover, other reporting on community benefits could be required, such as charity care, quality assurance, or transparency information. Its primary competitor, CSCDA, took similar actions when it proposed benefit guidelines that suggested that there are a "number of health care benefits that may directly benefit and improve the quality of life of the local community where a project is located" and provided a list of these potential benefits. While citing that absence of one of the benefits on the list does not mean there is a lack of public benefit associated with a proposed project, procedures are set in place allowing discretion for CSCDA program managers to address compliance with the guidelines in all future applications—presumably on a case-by-case basis.

Certainly, California is not the only state participating in the deliberations surrounding the issue of non-profit benefits associated with tax exempt bonds and how benefits should be conferred to the community. Much controversy exists surrounding the definition, measurement, and reporting of community benefits in general as well as specifically related to tax-exempt status. Other states have attempted to quantify or impose some type of charity care or community benefit provision on non-profit entities. For instance, the Illinois legislature considered a bill that would mandate hospitals to devote 8 percent of their annual operating costs to charity care—although the legislation ultimately was not passed. Moreover, while there are many fairly consistent definitions of charity care in the volumes of guidelines available to help organizations develop community benefit programs and demonstrate the entity is meeting their charitable tax-exempt purpose as community benefit organizations, none is currently considered authoritative. In its 2006 Guide on Community Benefit Reporting, the Catholic Healthcare Association itself acknowledges that "the community benefit role of not-for-profit health care organizations is not well understood—even by persons within" the organization. Thus, CHFFA should remove itself from this debate by incorporating its existing statutory definition until the health care and tax-exempt issues are vetted in the appropriate arenas.

No Other States have Pass-On Provisions

On a national level, California appears to be the only state that operates under a pass-on savings provision for its borrowers in the 34 other states that operated a separate or combination health care financing authority. As part of an informal CHFFA survey of other state authorities on the existence and impact of a pass-on requirement in their states, none of the 23 respondents mentioned a pass-on provision similar to California. Our research of on-line applications and websites for other states that did not respond to the survey indicated a similar lack of this kind of provision. Moreover, the consensus from these other states surveyed was that any pass-on requirement would place the state bond authority at a serious disadvantage with its other competitors. Since health care bond financing is not consistently

handled by a single-focused health care financing authority in these other states, but rather by an "umbrella" agency combining economic development and education financing with its health care authorities, it is difficult to directly compare California to other states.

For the 11 states with stand-alone health care only tax-exempt financing authorities, we found that they also face competition from other issuers although the competition is not as pronounced as in California. Specifically, four of these states mentioned they had no competition implying they were the sole conduit issuer for health bonds in their states—those states include Colorado, Idaho, New Jersey, and North Carolina as shown in Table G below:

Table G: Comparison of Conduit Issuer Competition Between States

Peer States To CHFFA	Sole Financer in State	1 Competitor	More Than 1 Competitor
Arizona			X
Colorado	X		
Delaware	No response provided	No response provided	No response provided
Idaho	X		
Michigan			X
Mississippi			X
New Jersey	X		
New Mexico		X	
North Carolina	X		
Washington	No response provided	No response provided	No response provided
West Virginia	No response provided	No response provided	No response provided

Source: Informal survey conducted by CHFFA in February 2008
Informal survey conducted by the Wisconsin Health and Education Facilities Authority in October 2007

Similar to California, many states indicated that local cities and counties can issue bonds, but on a much smaller scale. For instance, all cities and counties in Illinois can issue tax-exempt bonds; however, the Illinois Finance Authority noted that it controls more than 95 percent of the conduit financing in both the education and health care markets. Another state asserted they would "lose all our business to the cities and counties if we had a pass-on requirement." Other states also commented that it is not the financing authority's position to determine or rule over a community benefit standard or savings amount as those are policy questions to be answered by state legislature. For example, one state mentioned it performs "a traditional lenders review and does not deal with issues other than the borrower's ability to repay the loan…consideration of community benefit or similar non-financial standards is left to others."

Conclusion

Although once the primary conduit issuer of tax-exempt health care bonds in California, CHFFA now shares the market with a full complement of active competitors. CHFFA's past efforts to ensure borrowers' due diligence in passing-on the savings realized through tax-exempt financing to patients and the broader community have put the Authority at the center

of controversy and made it difficult for CHFFA to remain competitive in the tax-exempt bond financing market in California. In essence, CHFFA's tax-exempt bond activity has halted dramatically placing its existence in the market at risk. To ensure the continued survival of its services, the issue of a pass-on savings requirement on health facilities using conduit financing should be included in the national and statewide debates being waged regarding whether non-profits are contributing enough to the community to justify their special tax-exempt status. Whatever the outcome related to issuing tax-exempt debt, any statutory mandates and regulatory demands should be applied equally to all JPAs and similar issuers—not just CHFFA.

Recommendations

To address these issues, we recommend that CHFFA take a number of actions to regain its past role of being the issuer of choice for non-profit hospitals and health care facilities when they seek tax-exempt bond financing. Specifically, CHFFA should adopt the following bylaws or standards:

- Until statutes are amended to provide clarification of the "pass-on" provision, CHFFA should utilize the guidance from Government Code § 15438.5 (c) to measure community benefits derived by the hospital financing proposal. That section defines "significant community service" for a health facility to meet prior to approval, including contracting with Medi-Cal and/or meeting other requirements.
- This provision could be used as a possible template when developing a "pass-on" policy. Additional information related to key community benefit indicators, such as charity care, quality assurance or transparency reporting could also be required.
- Establish protocols for public and Board comments to emphasize that CHFFA's role is to assist hospital and health care facility development within California while assuring the creditworthiness and earning capacity of each project, together with the pledged revenues, debt service coverage, and basic security.
- Require that public comments be provided in advance in writing, and establish a time limit for each commenter's presentation.
- Provide the option of calling special sessions of the CHFFA Board between regularly scheduled hearings to conduct business, while meeting Bagley-Keene Act requirements for public notice.
- Modify and streamline CHFFA's application package to reduce unnecessary paperwork while assuring that financial eligibility standards are being met.
- Assist the Legislature in crafting language related to the pass-on requirement to assure that the final legislative solution does not place CHFFA at a competitive disadvantage with alternative issuers.